DEC 2018 / JAN 2019

PROFICIO

NFB FINANCIAL UPDATE

NFB PRIVATE WEALTH MANAGEMENT

FROM THE **CEO's** DESK

My golly. As I write this editorial it appears as if Mr. Gigaba has fallen on his proverbial rather small sword! Having displayed a remarkably common approach of denial and outrage, it seems like logic has prevailed and he has accepted his fate. Well, at least that is the position right now. Watch this space.

Steve Katzenellenbogen, a fellow director and I, were recently chatting about markets, returns and volatility. He showed me a graph which lives up to the adage that a picture speaks a thousand words.

To have sight of this remarkable graph, visit my LinkedIn page - https://za.linkedin.com/in/mike-estment-32062119.

Seldom is such dramatic volatility seen. The rather violent movement from the index speaks to our status, which includes being an EM (Emerging Market) currently under pressure globally, an unfortunate victim of over a decade of poor husbandry by our government, and in the run up to a rather important election.

Also, true, however, is the other key reality, which goes along the lines of smart money being greedy when everyone is panicking and beginning to panic when everyone else is being greedy! Our prime companies, our bonds and listed property companies are all reflecting unusually low earnings multiples and in some cases record dividend yields. The owners of these shares, bonds and property businesses, if patient, will be rewarded when the cycle reverses. The cause of the volatility is added to by the recent rise in US interest rates. This increase has given institutions an alternate to growth assets, and whilst it is common cause that the growth rate and Global GDP is still fairly robust, the cautious money is beginning to go to safe haven assets. Investors who enjoy the luxury of “enough” are always well advised to stay the chase, remain invested and capture the sometimes rather lumpy returns as and when they happen.

The nature of returns, timing and predictability vary quite materially between asset classes and different types of investment. The most commonly discussed investment classes in order from most tame and predictable, to the most volatile include: Cash, Bonds, Property and Equity. Historically less significant for South Africans (given the existence of Foreign Exchange Controls) was the effect of exchange rates and currency on investment. This has rapidly become a major consideration both in conversations about diversification, as well as volatility. This is most true for Emerging Market currencies, but has recently impacted the British Pound (Brexit) and others.

Some interesting takeouts whilst considering this information is the following:

- Cash and Inflation are good company. Seldom will you earn much more than inflation on a cash deposit. After all, the Central bank uses interest rate policy to manage increasing or decreasing inflation. The problem for investors in using interest as a savings tool includes the following:
  - You have to pay tax on interest, risking you effectively earning net much less than inflation
  - Interest income (particularly when markets are weak) feels safe and smart. This is particularly true whilst saving towards retirement. However, the risk inherent becomes starkly obvious when you retire. Suddenly the gross income is reduced by income tax due. The capital is compromised as it cannot grow unless the after-tax withdrawal is less than inflation. Interest rates can trend lower and stay low for protracted periods. This has been the case in the last decade as the world has recovered from the Global Financial Crisis.
  - This potential risk happens slowly to start, but then accelerates as your inflated income needs are made difficult or impossible by you eating into capital, paying more tax and most unpredictable, lower interest rates.

- Growth assets such as listed shares, and listed, or other property are generally great investments in the managing of the inflation risk mentioned above. The shares one owns afford you an interest on the income

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…take advantage of diversification. This does not imply continual changing. It does, however, suggest understanding your own tolerance for volatility, your income and capital requirements over the remainder of your life.

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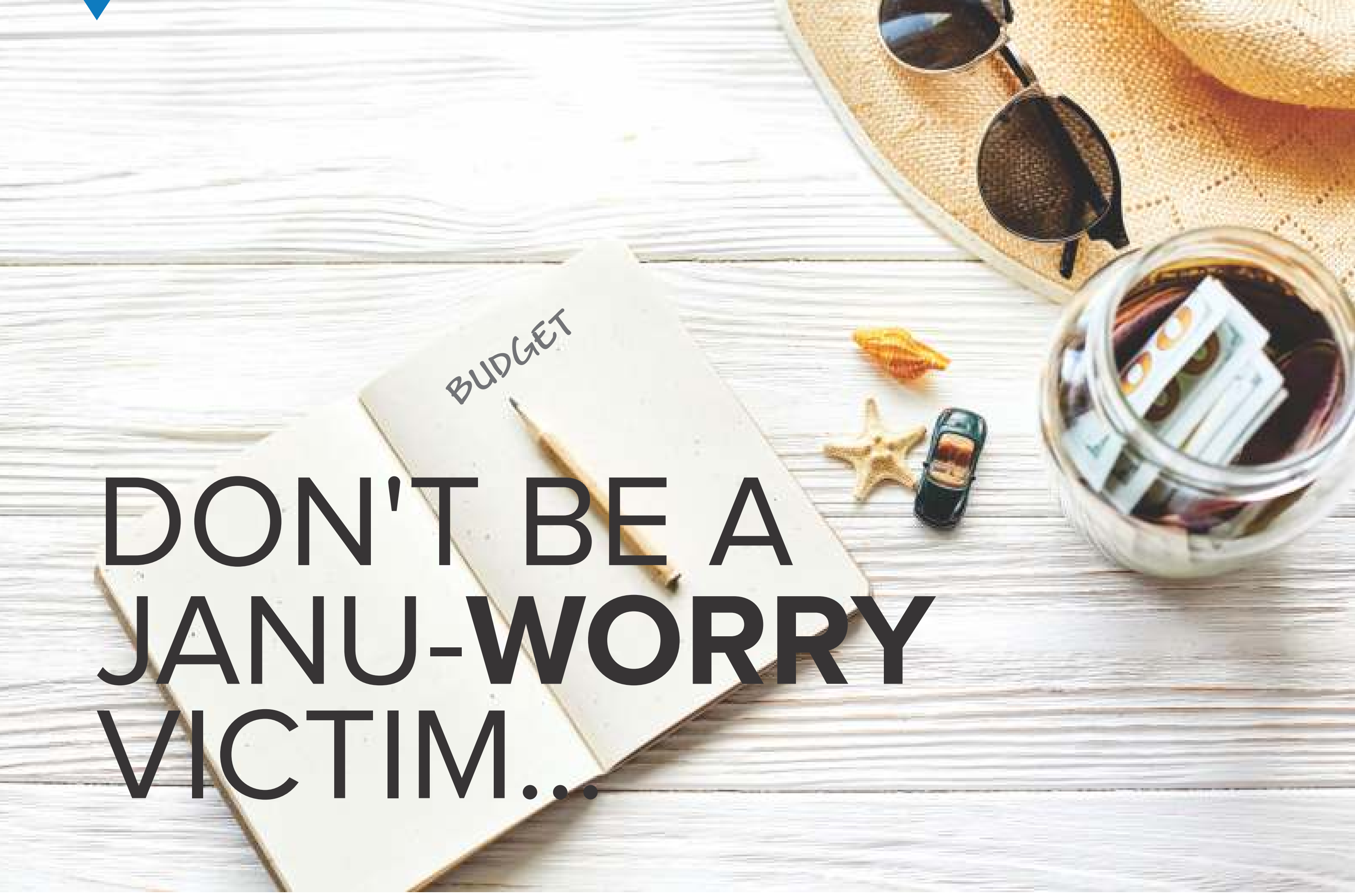
DON'T BE A JANU-**WORRY** VICTIM...



The festive season is synonymous with excess spending whether you are getting paid a weekly wage, fortnightly or monthly. With Christmas parties, the buying of presents, family vacations, new year's parties or even black-tax, there always seems to be additional spending happening over this season. This is in addition to getting salaries paid earlier which, more often than not, leads to January feeling like two months. Then January comes blazing in, with higher medical scheme costs, school supplies and fees. However, you should not despair... with proper planning, responsible spending and discipline, some of these elements can be mitigated.

You may be asking yourself how you do implement proper planning, responsible spending and discipline? The answer is: by drawing up a budget and cash flow statement. These won't only help you mitigate the previously mentioned elements, but they will also help in setting goals and objectives. Although these may seem like unrelated concepts, they both play a very important part in showing you what you think you do with your money and what you actually do with it. The difference between a budget and a cashflow statement, is that a budget is an estimate of future expected income and expected expenditure. A cashflow statement demonstrates actual income received and expenses incurred; a monthly bank statement is a good example of a cash flow statement because it reflects the flow of money on a monthly basis.

A budget is a good way to implement discipline and responsible spending. This is done by managing expenses to staying within the bounds of the expected income. A budget is done in advance and can therefore be used as a planning tool. An example of this is that if you are getting paid earlier in the month of December, make sure you are allocating enough funds for your expected expenses which will be due later in the month. If you are fortunate enough to be receiving a bonus, put aside additional funds to account for the higher medical aid scheme rates, insurance/investment policy anniversaries that have premium escalations and the higher cost of school supplies and fees. Once a budget has been drawn up, it must be implemented otherwise it's not worth the paper it's written on. Some factors that can influence the successful drafting and implementation of a budget are:

- **Involvement**
  - Involve the people that the budget will affect. If you're planning a family vacation, plan with the family for things like where you will be staying, food you will be eating, activities etc. This will result in controlled and responsible spending habits.

- **Being honest**
  - Be honest with yourself and those involved. If you have a joint budget with your spouse and you must contribute towards an extended family event, let your spouse know.

- **Setting realistic expectations**
  - The budget needs to be realistic. Don't be too aggressive or conservative with your estimation e.g. budgeting R500 for petrol a month when you travel 50 kilometre a day to work. Keep a record system in place; this will enable you to compare what you think you are spending and what you are actually spending.
  - For example: if you budget R1,000 per month for petrol, and you're spending R2,000 you can adjust the budget accordingly for the following month.
  - All those involved should communicate their individual goals and objectives. It should also be discussed whether these goals and objectives are realistic and how you are going to go about achieving them.
  - By communicating these and putting in place a strategy together with the budget you will be able to keep track with the plan.

- **Planning and time frames**
  - Set a time frame in which to achieve a specific goal.
  - For example, if you are planning a holiday in a years' time which

By failing to prepare, you are preparing to fail. - Benjamin Franklin

will cost R24,000, from January you should be putting away a minimum of R2,000 per month if you are planning to save for the full twelve months. These funds should be placed into a shot-term investment vehicle which will deter you from using the funds for other things.

- **Provide for flexibility**
  - The budget needs to provide for flexibility especially with changing circumstances. A major change should result in the budget being reviewed. Even if no major changes occur, the budget should be reviewed on an annual basis to see whether it can be made more efficient and accommodating.
  - An example of this would be if you had a co-payment for your child's braces or having to replace an expensive vehicle part. You would need to adjust the budget by reducing the holiday fund and perhaps extending the time frame to accommodate the change in circumstances

- **Implementation**
  - Follow through and stick to the plan. Otherwise there is no clear path or guideline in order to achieve your goals.

STEPS OF DRAFTING A BUDGET

1. Prepare to draft the initial budget
2. Calculate the estimated income from all sources
3. Calculate expenses
4. Compare income and expenses
5. Suggest a bi-annual review process

Putting together a budget and cashflow statement will not only assist you to mitigate the Janu-worry woes. It will put in place clear guidelines of what is required in order to meet your goals. By putting these guidelines in place and implementing them, you can say goodbye to Janu-worry, Febru-worry and March on forward with peace of mind.

BUDGET TEMPLATE

(1) Monthly Budget		
(2) Income	**Budget**	**Actual**
Salary		
Rental Income		
Income Total		
(3) Expense		
Bond		
Credit Card/Loan		
Water and Electricity		
School Fees		
Clothing		
Savings (RA, UT, TSFA)		
Insurance (Short/Long-term)		
Medical Aid		
Vehicle Repayments		
Petrol		
Groceries		
Cellphone		
Internet		
Holiday Fund		
Entertainment		
Gifts		
Expenses Total		
(4) Shortfall/Surplus		

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Once a budget has been drawn up, it must be implemented otherwise it's not worth the paper it's written on.

FROM THE **CEO's** DESK

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generated and capital growth or loss made by the companies. In well run companies, these two combine to offer long term, sustainable and inflation beating growth. The emphasis is on long term. The power of compounding plays an enormous role in the materially better outcome experienced from this type of investment decision.

- Probably the best advice of all is to take advantage of diversification. This does not imply continual changing. It does, however, suggest understanding your own tolerance for volatility, your income and capital requirements over the remainder of your life.

- Probably most important of all is the fact that aggressive, growth-oriented investments are not only for very wealthy investors. For less wealthy investors, they simply would make up a smaller, but no less important piece of the puzzle.

- My final thought or reminder is the fact that we are here to guide, discuss, consider, firstly your needs and then solutions, and also to answer any questions, in any way related to your wealth and well-being.

It is December in a few days' time. May I, on behalf of our Board of Directors, wonderful support staff and advisory team, thank you for your custom and support. Also, a big thank you to those of you that referred friends and family to NFB for advice and service.

RETIREMENT ANNUITIES & DIVORCE

Retirement annuity fund benefits do not form part of a member's estate, therefore, should a member be insolvent or have their estate sequestrated, the retirement benefit is protected from attachment or appropriation by any creditors. However, when it comes to divorce settlements this isn't the case. 2018 has been an interesting year having dealt with a number of cases pertaining to retirement funds and divorce orders. In this piece, I would like to focus on divorce settlements and specifically retirement annuities.

When a non-spouse is awarded a certain amount of pension interest, the divorce decree will usually be worded along these lines: *"The defendant is a member of Retirement Annuity ABC, the plaintiff is entitled to 50% of the defendant's pension interest in the fund as defined in section 1 of the Divorce Act. The fund is ordered to pay or transfer the assigned portion of the pension interest to the plaintiff or an approved fund on her behalf in terms of section 37D(4) of the Pension Funds Act."*

Pension interest in terms of the Divorce Act is defined as the total contributions made to the fund up to the date of divorce, plus simple annual interest at the prescribed rate. Please note, the pension interest may never be more than the actual value of the retirement annuity fund; if this is the case the actual retirement annuity value is used.

Example:
Mr X was married in community of property on 01 March 2000 and was divorced on 01 March 2018. His retirement annuity as at date of divorce is valued at R1,500,000. He had made the following contributions to his retirement annuity up to the date of divorce.

R100 000 - 01 February 2001
R100 000 - 01 February 2005
R100 000 - 01 February 2008
R100 000 - 01 February 2011
R100 000 - 01 February 2015

The total pension interest would be as follows, calculated at the current prescribed rate of interest of 10% per annum.

Date of contribution	Contributions	Annual Simple Interest	Pension Interest
01/02/2001	R100 000	R170 876.71	R270 876.71
01/02/2005	R100 000	R130 849.32	R230 849.32
01/02/2008	R100 000	R100 849.32	R200 849.32
01/02/2011	R100 000	R70 821.92	R170 821.92
01/02/2015	R100 000	R30 794.52	R130 749.52
	R500 000	**R504 191.78**	**R1 004 191.78**

The non-member spouse, in this instance, would be entitled to a specific percentage (stated in the Divorce Order) of the Pension Interest which is equal to R1,004,191.78 in the example.

The non-member spouse would then have the following options available to them:

- Take the full amount awarded as a cash lumpsum;
- Transfer a portion of the benefit to an approved retirement fund;
- Transfer the full benefit to an approved pension fund, preservation pension fund or retirement annuity.

All proceeds taken in cash by the non-member spouse will be taxed in their hands as per the withdrawal tax tables.

SECTION 14 TRANSFERS

Individuals married in community of property or out of community of with accrual should beware when considering consolidating their retirement annuity investments. The reason being, is when retirement annuity benefits are moved from one institution to another by way of a Section 14 transfer, the latter institution tends to consider that lumpsum transfer as a single contribution. This could potentially increase the Pension Interest calculated at divorce stage. The process of attaining the original information from the previous institution may prove to be an administrative burden.

Please note that this article only deals with Pension Interest with regards to Retirement Annuities. Pension, Provident funds and Government Employee Pension Fund Divorce settlements may be dealt with differently. Should you require assistance or advice in this regard, please do not hesitate to contact one of our NFB Private Wealth Managers on one of the below numbers. ■

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"2018 has been an interesting year having dealt with a number of cases pertaining to retirement funds and divorce orders."

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